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SUBJECT: KWACHA GENTLY SLIDES IN WAKE OF PRESIDENT'S DEATH

¶1. (SBU) Summary: Zambia's economy remains relatively sound, despite foreign exchange market fluctuations immediately following news of President Mwanawasa's death. Although the Zambian Kwacha has slipped slightly against the U.S. Dollar, it remains in line with historical averages. The Lusaka Stock Exchange remained open all week, yet the All Stock Index continued to fall. Zambian Government (GRZ) officials have reassured investors that Zambia's economic future is secure. Nevertheless, markets may continue to reflect the uncertainty bred by forthcoming presidential elections, as well as possible GRZ fiscal irresponsibility. End summary.

¶2. (U) Minutes after Acting President Rupiah Banda announced President Mwanawasa's death on Zambian television on August 19, the Zambian Kwacha (K) experienced a sudden slide in international currency markets, falling by K100 to K3,500/USD. By mid-week, the currency fell another three percent, to approximately K3,600/USD, before adjusting at week's end to K3,535/USD. Despite the recent weakening, the current exchange rate is stronger than the 12-month historical average of approximately K3,700/USD and well within the normal range of activity. An economist at Standard Bank Zambia, a South African subsidiary, described the exchange rate as "a barometer for the sentiment of the international community." She said Standard Bank "expects it to remain stable in the period leading up to the elections, barring any alarming development, which is highly unlikely in a politically stable country like Zambia."

¶3. (SBU) Within hours of Banda's announcement, Finance Minister Ng'andu Magande sought to ensure international investors that the GRZ will continue to pursue market-friendly policies. In an interview with Reuters, Magande insisted that the GRZ's macroeconomic policy will continue. Secretary of the Treasury Evans Chibiliti made similar comments, assuring reporters that the GRZ is well-prepared to continue implementing Mwanawasa's economic agenda, and that the budget cycle will remain on track. A private sector analyst suggested to emboff that the GRZ is keen to "steel investors' nerves" given that foreign investment in GRZ securities has risen to USD 257 million from practically zero in recent years. Magande's interview with international financial journalists so early in the mourning period may also have served his presidential ambitions.

¶4. (SBU) Zambia's equity market, the Lusaka Stock Exchange (LuSe), was less affected by the news of President Mwanawasa's death. During the week ending August 22, the LuSe All Share Index (LASI) experienced a modest decline, closing at 3,663, twenty points below the August 15 level. A LuSe broker told emboff that the recent drop is part of a decline that began earlier in the summer, when a large number of local investors floated their shares in order to obtain capital to compete in a highly-anticipated initial public offering of a telecommunications company, Celtel. When Celtel's share price fell, in response to a financial report in July, local and international investors alike dumped

equities.

15. (SBU) The LuSe broker conceded that Mwanawasa's stroke also had some bearing on the LASI, which peaked at over 4,200 in late June, with international investors expressing some concern about political uncertainty. The drop in share prices, which roughly coincided with President Mwanawasa's stroke on June 29, suggests that investors reacted to the knell of Mwanawasa's ailing health--and the exchange bore the impact of market uncertainty--in advance of the President's passing away on August 19. A United States-based private sector analyst told emboff that "institutional investors will take a 'wait and see' approach to treasury bonds and currency exposure."

16. (SBU) Comment: Zambia's capital and foreign exchange markets seem to have absorbed the economic shock of the President's death without undermining the country's growth prospects. Nevertheless, markets are likely to experience additional volatility in the lead-up to the presidential elections, particularly given strong levels of support for the populist presidential candidate Michael Sata, who built his 2006 campaign on a platform of anti-(foreign) investment and intolerance. Additionally, GRZ discretionary spending is set to increase manifold in the year's fourth quarter, due to the unbudgeted costs associated with the state funeral and presidential election. A recent GRZ pledge to increase its fertilizer support program by almost three hundred percent, an across the board salary increase for Members of Parliament, and the ruling Movement for Multiparty Democracy's potential (illegitimate) use of government resources on campaigning may further weaken Zambia's

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macroeconomic performance and the GRZ's reputation for fiscal discipline.

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